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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 270

BLACKHAWK-PERRY CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

SUPPLEMENTAL BRIEF FOR PETITIONER

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The petition and the brief in support thereof point out the distinction between this case and the *Virginian Hotel* case and advance that distinction as a reason why the Court should not consider itself bound by the *Virginian Hotel* rule. Even if the Court should conclude that no such distinction exists, however, it should assuredly take this opportunity to overrule *Virginian Hotel,* the unfairness and unreasonableness of which are here highlighted as never before in actual litigation by the simple facts of this case.

Reduced to its essence, the present case presents the following picture: The taxpayer in 1935, relying upon an invalid Treasury Regulation, attributed to its property then acquired an erroneously high basis. There is no question but that this basis was wrong as a matter of law from the

very beginning, in the light of facts then known. Thereafter the taxpayer applied the correct rate of depreciation to its erroneously high basis and entered the resulting figures on its tax returns. The error resulted in no tax benefit during the years 1935 through 1941 since the taxpayer would have had a net loss for each of those years even if only the correct depreciation deduction had been shown. The Commissioner accepted the taxpayer's returns without question during those years, but asserted deficiencies against the taxpayer for the years 1942, 1943 and 1944—the first profit years—basing his determination on the disallowance of depreciation deductions for those years.

He first established the correct basis of the property at the time of acquisition in 1935, thus correcting the taxpayer's original error, and then concluded that that correct basis should be reduced by the erroneously high depreciation figures which the taxpayer had entered on its books and tax returns in the intervening years, although the error in those figures resulted solely from the use by the taxpayer of the incorrect original basis. The result was that in the taxable years in question the Commissioner concluded that the taxpayer had no adjusted basis left against which he might apply any depreciation deduction. Thus the Commissioner corrected the taxpayer's error (which in reality was as much his as the taxpayer's) to the extent that the correction worked in favor of the Government, but refused to correct the error to the extent that the correction would have worked in favor of the taxpayer. The Commissioner contended, and both Courts below held, that the *Virginian Hotel* case established the inflexible rule that in every case where a depreciation deduction is entered on a tax return and not challenged it is "allowed" within the meaning of Section 113(b)(1)(B) of the Internal Revenue Code.

It seems patently absurd to say that in any substantial sense an erroneous depreciation figure is "allowed" by the

Commissioner and that consequently the taxpayer cannot restore to basis the erroneous deduction when, at the first occasion when it becomes of any importance, the Commissioner *disallows* the very basis upon which the depreciation is computed and when no benefit to the taxpayer or harm to the Government resulted from the prior error. Either the *Virginian Hotel* decision does not require any such result or if it does, this Court would clearly wish to re-examine the decision and lay down a rule which is not altogether out of keeping with reason and common sense.

Petitioner frankly concedes that this Court has denied certiorari in four cases which have raised the question of the correctness of the *Virginian Hotel* rule. *Commerce Co.* v. *United States,* 171 F. 2d 189, *cert. denied* 336 U. S. 972; *Bank of America* v. *United States,* 168 F. 2d 399, *cert denied,* 335 U. S. 827; *Repplier Coal Co.* v. *Commissioner,* 140 F. 2d 554, *cert. denied,* 323 U. S. 736; and *Piedmont Cotton Mills* v. *Commissioner,* 177 F. 2d 148, *cert. denied,* 339 U. S. 919. In all of those cases, however, the Government has merely contended that, having once been decided, the *Virginian Hotel* issue should not be reexamined. It has never met frankly the compelling arguments advanced by taxpayers in support of their contention that the *Virginian Hotel* decision should be overruled or limited. See for example the petition and response in *Piedmont Cotton Mills* v. *Commissioner, supra.* We submit that if the Government addressed itself to the merits of this controversy, it would be clearly apparent to the Court that it had promulgated an erroneous rule which should be corrected.

In those instances in which it has sought to justify or minimize the significance of the *Virginian Hotel* rule, the Government has addressed itself almost exclusively to cases where the depreciation figures entered on taxpayer's returns resulted from a determination of useful life of property which was correct in the light of the facts reasonably

known to exist at the time the determination was made and which turned out to be erroneous only in the light of later facts.[1] Such depreciation figures are "allowable"[2] and the question whether they have been "allowed" is immaterial. The Government has thus evaded the issue presented in a case such as the present where depreciation is erroneous in the light of facts existing at the time the depreciation deduction is entered on the return.

In the present case the taxpayer has been denied the right to correct an error, although, as the facts incontrovertibly reveal, it was a genuine error at the time it was made, and although it resulted in no damage to the Government or gain to the taxpayer. And this although the Government is actually profiting from the mistake, since it collected taxes for the years 1942-1944 to which it would not have been entitled if the error had not occurred, notwithstanding that the error caused no loss of taxes in the earlier years. Such a harsh rule has never been applied in any other instance in the field of income taxation from 1913 to date, and no reason has ever been suggested why Congress would have intended to apply such a rule here. The rule is attributable, we submit, to a misunderstanding on the part of this Court and on the part of counsel for the Government in the *Virginian Hotel* case, of the basic principles of tax administration, which have universally disregarded all errors in returns for prior years where there is no basis for estoppel and have not permitted harmless errors in prior years returns to distort income in a later year.

The rationale of the *Virginian Hotel* decision is that if deductions are not *"challenged"* by the Commissioner they are *"allowed"*. The Court below squarely bases its

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[1] See e.g., Brief for Commissioner, *Virginian Hotel Corporation* v. *Helvering*, pp. 9, 21-22.

[2] *Commissioner* v. *Mutual Fertilizer Co.*, 159 F. 2d 470 (C.A. 5th, 1947) (Citing relevant Treasury Regulations).

decision upon that sole premise.[3] That premise overlooks the fact that where the correction of an excessively high depreciation deduction would result in no increase in tax liability there is no procedure whereby the Commissioner can *challenge* the deduction. His only authority is to make corrections which are required for a correct determination of tax liability. Where a correction would not affect tax liability—and it is stipulated in this case that the use of correct depreciation figures would not have resulted in any taxable income for any of the years 1935-1941—the Commissioner has no reason or authority to make any correction. This the Government will freely admit. And it is clear, therefore, that since the Commissioner has no reason or authority to act, his failure to act can have no significance. This Court, however has attributed great significance to the Commissioner's failure to exercise an authority which he obviously does not have. A decision based upon a premise so obviously false could not fail to produce absurd results. Where, as in the case at bar, it leads to a holding that the correction of a harmless error in prior years' returns is permitted for one purpose and denied for another the result verges on the ridiculous.

In these times when taxes have recently been substantially increased and will certainly be raised to extremely high levels, it is of the utmost importance that their administration be rational and just. With a view toward the accomplishment of this significant end, we submit that the Court should grant this petition and overrule its decision in the *Virginian Hotel* case or explain the decision as having a much narrower application than is attributed to it by the Commissioner and by the Court below. By so doing it will violate no principle of *stare decisis;* it will

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[3] "If deductions are not challenged (by the Commissioner) they certainly are 'allowed' ", R. 43.

disturb no rights which have arisen in reliance on the *Virginian Hotel* rule; it will simply eliminate an erroneous and unfair rule of tax law for which no one has ever offered a single valid justification. The importance to the Government of the good will and respect of taxpayers is difficult to exaggerate. Nothing tends more to destroy taxpayer morale than to make taxes depend upon rules which are arbitrary and capricious.

Respectfully submitted,

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